

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-118966-97]

RIN 1545-AV69

Information Reporting With Respect to Certain Foreign Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations under section 6038 of the Internal Revenue Code providing information reporting requirements for certain United States persons holding interests in controlled foreign partnerships. The proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. These proposed regulations would provide guidance to United States persons who must file such a return. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by November 9, 1998. Outlines of topics to be discussed at the public hearing scheduled for November 10, 1998, at 10 a.m., must be received by October 20, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-118966-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to:

CC:DOM:CORP:R (REG-118966-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC.

Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

A public hearing has been scheduled to be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Victoria Scotto Balacek, 202-622-3860; concerning submissions and requests for a hearing, Michael Slaughter, 202-622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC. 20503, with copies to the **Internal Revenue Service**, Attention: IRS Reports Clearance Officer OP:FS:FP, Washington, DC. 20224. Comments on the collection of information must be received by November 9, 1998. Comments are

specifically requested on:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of the capital or start-up costs of operation, maintenance, and purchase of services to provide information.

The collection of information in these regulations is in §1.6038-3. This information is required by the IRS to identify foreign partnerships which are controlled by United States persons and verify amounts reported by the partners. The collection of information is mandatory. The likely respondents will be individuals and businesses or other for-profit organizations.

The burden of complying with the proposed collection of information required to be reported on Form 8865 is reflected in the burden for Form 8865.

The burden of complying with the proposed collection of information in §1.6038-3(c)(3) is as follows:

Estimated total annual reporting burden: 250 hours.

Estimated annual burden per respondent: .25 hours to 1 hour, with an average of .5 hours.

Estimated number of respondents: 500.

Estimated frequency of responses: Annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Taxpayer Relief Act of 1997

In the Taxpayer Relief Act of 1997 (TRA 1997), Public Law 105-34 (111 Stat. 983 (1997)), Congress significantly modified the information reporting requirements with respect to foreign partnerships under sections 6038, 6038B and 6046A (and also amended section 6501(c)(8) to provide that the statute of limitations on the assessment of tax under sections 6038, 6038B and 6046A does not expire until three years after the information required under those sections is reported). These regulations under section 6038 are being proposed along with regulations under sections 6038B (reporting of certain transfers to foreign

partnerships) and 6046A (reporting of certain ownership interests in foreign partnerships). The IRS is also developing a comprehensive form (Form 8865) for reporting under all of these provisions. A draft version of the form will be issued for public comment while the proposed regulations are outstanding.

Section 6038

Prior to TRA 1997, reporting in respect of foreign partnerships was governed by section 6031 of the Internal Revenue Code (Code). Regulations had been proposed, but never finalized, that would have required reporting by foreign partnerships where United States persons were allocated 25 percent or more of certain items. Section 1141 of TRA 1997, amended section 6031 to provide that a foreign partnership is required to file an annual return of partnership income (Form 1065) only if the partnership has gross income from sources within the United States, or gross income that is effectively connected with the conduct of a U.S. trade or business. Section 1142 of TRA 1997, amended section 6038 to require information reporting by certain United States persons with direct or indirect interests in controlled foreign partnerships. Thus, these changes moved the statutory authority to require annual reporting on a foreign partnership because of the ownership interests of United States persons from section 6031 to section 6038, and moved the reporting obligation in respect of foreign partnerships from the partnership to the partner level.

Explanation of Provisions

Section 6038 requires certain United States persons that own interests in controlled foreign partnerships to provide information with respect to the interests as prescribed by the Secretary. The proposed regulations implement the statute by requiring taxpayers to furnish the IRS with annual information.

Reporting Requirements

The proposed regulations implement the rules of section 6038 by requiring a United States person that controls a foreign partnership to file an annual information return with respect to the foreign partnership (Form 8865). Pursuant to section 6038(e)(3), the proposed regulations define control as direct or indirect ownership of more than a 50-percent interest in the partnership. The constructive ownership rules of section 267(c) (other than paragraph (3)) are applied to determine ownership interests (taking into account that such rules refer to corporations and not to partnerships).

A 50-percent interest in a partnership is defined as an interest equal to 50 percent of the capital interest, 50 percent of the profits interest, or, exercising the regulatory authority under section 6038(e)(3)(A)(ii), an interest to which 50 percent of the deductions or losses are allocated. Defining control by reference to losses or deductions, as well as capital and profits, is appropriate, because a partner with a greater than 50-percent allocation of these items has a level of control sufficient to provide a significant amount of information about the partnership. Furthermore, in the case of such allocations,

certain information is required to ensure that the rules of Code provisions such as section 704(b) (determination of distributive share) are being followed.

To relieve taxpayers of unnecessary filing burdens, the regulations provide exceptions from the general rule that a controlling partner must provide information to the IRS on Form 8865. If more than one United States person is required to report as a controlling partner, then one such controlling partner may file the required information in lieu of all such partners having to file separately. However, a controlling partner with respect only to losses or deductions may only satisfy this requirement if there are no controlling partners with respect to capital or profits. The controlling partners not required to file, must file the statement required by the regulations with their tax return indicating that the filing requirement will be met by another person and identifying that person.

Pursuant to section 6038(a)(5), the proposed regulations provide that each United States person that owns at least a 10-percent interest in a foreign partnership that is controlled by United States persons holding at least 10-percent interests must file an annual information return with respect to the partnership. In accordance with the statute, however, such 10-percent partners will not be required to report such information where there is a United States person that is a controlling partner. The proposed regulations define a 10-percent interest

in a partnership as an interest equal to 10 percent of the capital or profits interest, and an interest to which 10 percent of the deductions or losses are allocated.

Because no one United States person controls the partnership, Form 8865 will require less information to be reported than it will for controlling United States partners, and will be more similar to the information contained in Schedule K-1 to Form 1065. If there is a controlling partner (and, thus, any other 10-percent partners are not required to file), the controlling partner must, generally, file the information that would otherwise have been required from such 10-percent partners.

Exceptions to Filing Requirements

The proposed regulations provide that certain United States persons that are indirect partners need not file under section 6038 so long as the United States person from whom ownership is attributed does file the information, and the indirect partner files a statement with its income tax return identifying the United States person that will meet the filing requirements.

The reporting requirements of this section shall not apply in respect of any foreign partnership which is an eligible partnership described in §1.761-2(a) that has validly elected pursuant to §1.761-2(b)(2)(i) to be wholly excluded from the application of subchapter K. Nor shall the reporting requirements of these proposed regulations apply to any foreign partnership validly deemed to have wholly elected out of the provisions of subchapter K as specified in §1.761-2(b)(2)(ii).

Taxpayers are reminded, however, that a precondition to being an "electing-out" partnership is that, as provided in §1.761-2(a)(1), "[t]he members of such organization must be able to compute their income without the necessity of computing partnership taxable income." The IRS and Treasury are concerned that in certain cases the necessary books and records are not being maintained to allow verification that such computations can indeed be made without regard to the partnership. If it appears that, in the absence of a reporting requirement under this section, the members of the "electing-out" partnership cannot make such separate computations, this exception to the reporting requirements will be reconsidered.

Information Required

The proposed regulations require certain United States persons to provide information relating to the foreign partnership on Form 8865 (or successor form). The form will require controlling partners of foreign partnerships to report information concerning the income and assets of the partnership, certain transactions with the partnership, the names of the partners in the partnership, and other specified information. The form will require a partner holding at least a 10-percent interest in a controlled foreign partnership (where there is no United States person that is a controlling partner) to report information with respect only to its own interest in the partnership.

Time and Place for Filing

The proposed regulations require Form 8865 to be filed with the United States person's income tax return (including a partnership return of income) for the taxable year in which the partnership's annual accounting period ends. If required by the instructions to Form 8865, a duplicate Form 8865 must also be filed.

Failure to Provide Information

As described in section 6038(b), the proposed regulations provide that a failure to comply with the reporting requirements of section 6038 will result in a penalty of \$10,000 for each annual accounting period. Additional penalties apply for failure to comply after notification by the IRS, up to a total of \$50,000 for each annual accounting period. Also, as provided in section 6038(c), the proposed regulations additionally provide a penalty of reducing the United States person's foreign tax credit (also with further penalties for continued failure to report after notification).

Effective Dates

The proposed regulations would apply for annual accounting periods beginning after the date that these regulations are published as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the

Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations. It is hereby certified that the collection of information contained in these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time required to complete the form and file the information required under these regulations is brief and will not have a significant impact on those small entities that are required to provide notification. Furthermore, the number of small entities that will be required to file the form is not significant. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the Internal Revenue Service. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for Tuesday, November 10, 1998, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the

Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by [INSERT DATE 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER] and an outline of the topics to be discussed (a signed original and eight (8) copies) by October 20, 1998.

A period of 10 minutes will be allotted for each person making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this regulation is Victoria Scotto Balacek, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in its development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended

by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6038-3 is also issued under 26 U.S.C. 6038.* * *

Par. 2. Section 1.6038-3 is added to read as follows:

§1.6038-3 Information returns required of United States persons with respect to foreign partnerships.

(a) Persons required to make return--(1) Controlling partners. Every United States person that controls a foreign partnership must file an annual information return on Form 8865 "Information Return of U.S. Persons With Respect To Certain Foreign Partnerships" containing so much of the information described in paragraph (f) of this section, and such other information, as the form (or accompanying instructions) may prescribe. The information required to be filed by such controlling partner will include such information regarding any other United States persons that are 10-percent or greater partners in the foreign partnership as Form 8865 may require. (For exceptions to this rule, see paragraph (c) of this section.)

(2) Certain 10-percent partners. Every United States person that holds a 10-percent or greater interest in a foreign partnership controlled by United States persons holding at least 10-percent interests must complete and file an annual information return on Form 8865 containing so much of the information described in paragraph (f) of this section, and such other information, as the form (or accompanying instructions) may prescribe. (For exceptions to this rule, see paragraph (c) of

this section.) However, no such person will be required to file under this section if a United States person is a controlling partner of such partnership.

(3) Separate returns for each partnership. A United States person required to report under this paragraph (a) must file a separate annual information return for each foreign partnership with respect to which the person has a reporting obligation.

(b) Ownership determinations--(1) Control. A person (or persons) is deemed to be in control of a partnership if that person (or persons) owns, directly or indirectly, more than a 50-percent interest in the partnership (a controlling partner).

(2) 50-percent interest. A 50-percent interest in a partnership is an interest equal to 50 percent of the capital interest, 50 percent of the profits interest, or an interest to which 50 percent of the deductions or losses are allocated.

(3) 10-percent interest. A 10-percent interest in a partnership is an interest equal to 10 percent of the capital interest, 10 percent of the profits interest, or an interest to which 10 percent of the deductions or losses are allocated.

(4) Attribution rules. For purposes of determining an interest in a partnership, the rules of section 267(c) (other than section 267(c)(3)) apply (taking into account such rules refer to corporations and not to partnerships).

(5) Determination of amount of interest. Whether a person has a 50-percent interest, or a 10-percent interest, as described in paragraphs (b)(2) and (3) of this section, will be determined

for each taxable year by reference to the agreement of the partners relating to such interests during the taxable year.

(c) Exceptions when more than one partner is required to file duplicative information--(1) More than one controlling partner--(i) In general. If, with respect to the same foreign partnership for the same annual accounting period, more than one United States person is required to file an information return under paragraph (a)(1) of this section by reason of being a controlling partner, then in lieu of all such controlling partners making separate returns, only one return from one of the controlling partners will be required. However, a return by a United States person that is a controlling partner by reason of an interest to which losses or deductions are allocated may only satisfy this exception if there is no United States person that is a controlling partner by reason of an interest in capital or profits.

(ii) Manner of reporting. The return must be filed with the income tax return of the person making the return in the manner provided by Form 8865 and the accompanying instructions. The return must contain all of the information which would have been required to be reported by this section if separate information returns had been filed.

(iii) Controlling partners not required to file. Those partners not required to file under paragraph (c)(1)(i) of this section must file the statement required by paragraph (c)(3) of this section.

(2) Certain indirect owners excepted from furnishing information. Any United States person required to file an information return under this section need not furnish a return, if all of the following conditions are met--

(i) The person does not directly own any interest in the foreign partnership;

(ii) The person is required to file the information return solely by reason of attribution of ownership from a United States person under paragraph (b)(4) of this section; and

(iii) The United States person from whom the ownership interest is attributed files all of the information required under this section.

(3) Statement required. A United States person that does not furnish an information return under the provisions of paragraph (c)(1) or (2) of this section must file a statement with the person's income tax return--

(i) Indicating that the filing requirement has been or will be satisfied;

(ii) Identifying the person required to file the return;

(iii) Identifying the IRS Service Center where the return is required to be filed; and

(iv) Providing any additional information as Form 8865 and the accompanying instructions may require.

(d) Reporting under this section not required of partnerships excluded from the application of subchapter K--(1) Election to be wholly excluded. The reporting requirements of

this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership has validly elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified in §1.761-2(b)(2)(i).

(2) Deemed excluded. The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in §1.761-2(a) in which that United States person is a partner, if such partnership is validly deemed to have elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in accordance with the provisions of §1.761-2(b)(2)(ii).

(e) Period covered by return. The information required under this section must be furnished for the annual accounting period of the foreign partnership ending with or within the United States person's taxable year. The partnership's annual accounting period is the annual period on the basis of which it regularly computes its income in keeping its books. (See section 706 for the partnership's taxable year.)

(f) Contents of return. The return required to be filed under this section must contain information in such form or manner as Form 8865 (and its accompanying instructions) prescribes with respect to each foreign partnership, including--

(1) The name, address, and employer identification number, if any, of the partnership;

(2) The nature of the partnership's business and principal place where conducted;

(3) The date of organization and country under whose laws the partnership was organized;

(4) A balance sheet showing assets, liability, and capital of the partnership as of the end of the annual accounting period;

(5) A summary of the outstanding ownership interests in the partnership;

(6) A summary showing the total amount of transactions between the partnership and the person required to file the return, any other partnership or corporation controlled by that person, or any United States person owning at the time of the transaction at least a 10-percent interest in the foreign partnership;

(7) The amount of the partnership's foreign income taxes paid or accrued;

(8) A statement of the partnership's income for the annual accounting period;

(9) A statement of the partners' distributive share items of income, gain, losses, deductions and credits; and

(10) A statement of income, gain, losses, deductions and credits allocated to each United States person holding at least a 10-percent interest in the foreign partnership.

(g) Method of reporting. Except as otherwise provided on Form 8865 or the accompanying instructions, all amounts required to be furnished on the information return must be expressed in

United States dollars with a statement of the exchange rates used. All statements required on or with Form 8865 pursuant to this section must be in the English language.

(h) Time and place for filing return--(1) In general. Form 8865 must be filed with the United States person's income tax return (including a partnership return of income) on or before the due date required by law (including extensions) of that return.

(2) Duplicate return. If required by the instructions to Form 8865, a duplicate Form 8865 must also be filed.

(i) Definition of United States person. The term United States person is defined in section 7701(a)(30).

(j) Failure to comply with reporting requirement--(1) Dollar amount penalty--(i) In general. Any United States person required to file an information return under Section 6038 and paragraph (a) of this section that fails to comply (as defined in paragraph (j)(3) of this section) with the applicable reporting requirements of this section, must pay a penalty of \$10,000 for each annual accounting period of each foreign partnership with respect to which the failure occurs.

(ii) Increase in penalty. If a failure to comply with the applicable reporting requirements of section 6038 and this section continues for more than 90 days after the date on which the district director mails notice of the failure to the United States person required to file Form 8865, the person must pay an additional penalty of \$10,000 for each 30-day period (or fraction

thereof) during which the failure continues after the 90-day period has expired.

(iii) Limitation. The additional penalty imposed on any United States person by section 6038(b)(2) and paragraph (j)(1)(ii) of this section is limited to a maximum of \$50,000 for each partnership for each annual accounting period with respect to which the failure occurs.

(2) Penalty of reducing foreign tax credit--(i) Effect on foreign tax credit. Failure to comply with the reporting requirements of section 6038 and this section may cause a reduction of foreign tax credits under section 901 (taxes of foreign countries and of possessions of the United States). In applying section 901 to a United States person for any taxable year within which its foreign partnership's annual accounting period ended, the amount of taxes paid (and deemed paid under sections 902 and 960) by the United States person will be reduced by 10 percent if the person fails to comply. However, no tax deemed paid under section 904(c) will be reduced under the provisions of this paragraph (j)(2)(i).

(ii) Reduction for continued failure. If a failure to comply with the reporting requirements of section 6038 and this section continues for more than 90 days after the date on which the district director mails notice of the failure to the person required to file Form 8865, then the amount of the reduction in paragraph (j)(2)(i) of this section will be 10 percent, plus an additional 5 percent for each 3-month period (or fraction

thereof) during which the failure continues after the 90-day period has expired.

(iii) Limitation on reduction. The amount of the reduction under paragraph (j)(2)(ii) of this section for each failure to furnish information required under this section will not exceed the greater of \$10,000, or the income of the foreign partnership for its annual accounting period with respect to which the failure occurs.

(iv) Offset for dollar amount penalty imposed. The total amount of the reduction which, but for this paragraph (j)(2)(iv), may be made under this paragraph (j)(2) with respect to any separate failure, may not exceed the maximum amount of the reductions which may be imposed, reduced (but not below zero) by the dollar amount penalty imposed by paragraph (j)(1) of this section with respect to the failure.

(3) Failure to comply. A failure to comply is separately determined for each foreign partnership for which a United States person has a reporting obligation. A failure to comply with the requirements of section 6038 includes--

(i) The failure to report at the proper time and in the proper manner any information required to be reported under the rules of this section; or

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section.

(4) Reasonable cause limitation. The time prescribed for furnishing information under paragraph (h) of this section, and

the beginning of the 90-day period after the district director mails notice under paragraphs (j)(1)(ii) and (2)(ii) of this section, will be treated as being not earlier than the last day on which reasonable cause existed for failure to furnish the information. The United States person may show reasonable cause by providing a written statement to the district director having jurisdiction of the person's return for the year of the transfer, setting forth the reasons for the failure to comply. Whether a failure to comply was due to reasonable cause will be determined by the district director under all facts and circumstances.

(5) Statute of limitations. For exceptions to the limitations on assessment and collection in the event of a failure to provide information under section 6038, see section 6501(c)(8).

(k) Effective date. This section applies to annual accounting periods of a partnership beginning on or after the date final regulations on this subject are published in the **Federal Register**.

Michael P. Dolan

Deputy Commissioner of Internal Revenue